guaranteed access fund payments; and (2) FPA's stock decrease after March 20, 1998, was not caused by revelations regarding guaranteed access-fund payments."). Deloitte's evidentiary showing clearly anticipated, and met, the *Dura* standard.[5]

It is disingenuous for Petitioners to argue that anything in *Dura* changed the legal landscape in a way that helps them. *Dura* confirmed that loss causation requires a causal connection between an alleged misrepresentation and a subsequent price decline. Deloitte proved, among other things, that no such connection existed in this case, and it did so with *unrebutted* evidence.

The Ninth Circuit's conclusion that Deloitte had established its affirmative defense of loss causation is fully consistent with *Dura* and raises no issue for review by this Court.

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[5] Because both improper price inflation and a causal connection to a subsequent price decline are necessary aspects of loss causation, Deloitte could have supported its affirmative defense by negating just one of these aspects. However, Deloitte's unrebutted evidence negated both.

CONCLUSION

For these reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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In The
Supreme Court of the United States

CHARLES T. MADDEN, et al.,

Petitioners,

v.

DELOITTE & TOUCHE LLP,

Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

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I. The brief in opposition establishes that Circuit court interpretations of materiality under Section 11 conflict with precedents of this Court and the statutory text Congress enacted.

Respondent's brief highlights the importance of the first question presented: Whether purchasers in a registered securities offering establish the materiality of audit opinions that were false when the registration statement became effective if the total mix of information *made available in the registration statement* conceals the truth.

Respondent incorrectly argues that all Circuit courts would charge purchasers in a registered offering with constructive knowledge of information outside a registration statement that they can conceivably find if they already know where to look, without regard to the resources or sophistication that they would need to find the information and use it to determine that the auditor had made material misrepresentations to them.

Even if all Circuit courts actually held this view – which they do not – it cannot be reconciled with Section 11's plain language requiring an auditor to "prove[] that at the time of such acquisition [the purchaser] *knew of* such untruth or omission." 15 U.S.C. § 77k(a) (emphasis added); *see* Appendix to Petition ("App.") 44a. Respondent's brief never cites or correctly quotes either Section 11(a) or this Court's holding in *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976) (emphasis added): materiality is established when "the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information *made available*." Both the opinions below and Respondent's brief truncate the italicized words. *See* App. 4a, 20a-21a; Brief in Opposition ("Opp."), *passim*. These crucial words reflect Congress's decision to assign to auditors like Respondent the duty to reasonably investigate and make available the true information to purchasers in a registered securities offering.

Respondent argues that the courts below could presume Petitioners knew that Respondent had materially misstated FPA's financial condition based on reports of financial analysts. But those reports were not part of the registration statement. Respondent offered no evidence that Petitioners had actual knowledge of these reports or that they were made *reasonably available* to Petitioners, in the news media or otherwise. None of the reports warned that FPA faced imminent bankruptcy or had a negative net worth. The courts below nonetheless gave greater legal significance to these reports, prepared by strangers to the transaction with no Securities Act duties, than to the audit certification that Section 11 required Respondent to issue after a diligent investigation for Petitioners' benefit.

The Circuit courts indeed conflict on this issue. Respondent admits that one line of cases "based their holdings on information within the four corners of the challenged prospectuses" *[sic]*. Opp. 4 (citing *In re Donald J. Trump Casino Sec. Litig.*, 7 F.3d 357 (3d Cir. 1993); *Krim v. BancTexas Group, Inc.*, 989 F.2d 1435 (5th Cir. 1993)). The silence of these cases on information outside the registration statement confirms rather than contradicts their explicit holdings that only "the 'total mix' of information *the document* provided investors" can determine materiality. *Trump*, 7 F.3d at 371. Other cases limit the materiality inquiry to information "readily available" or "reasonably available" to investors, such as firm- or industry-specific "facts of life" that "newspapers report . . . regularly." *Kapps v. Torch Offshore, Inc.*, 379 F.3d 207, 214, 216 (5th Cir. 2004); *Wielgos v. Commonwealth Edison Co.*, 892 F.2d 509, 512 (7th Cir. 1989). But even these cases do not consider parties to the registration statement "free to make material misrepresentations" or omissions. *Kapps*, 379 F.2d at 213.

Contrary to Respondent's argument, both the decisions below and *Romine v. Acxiom Corp.*, 296 F.3d 701 (8th Cir. 2002) conflict with these authorities because they

permitted misrepresentations of specific financial information that investors could not find correctly stated anywhere else. In *Romine*, the plaintiffs alleged three distinct misrepresentations; Respondent cites only the discussion of the third allegation, which does not bear on the Circuit split because the truth appeared in a document explicitly incorporated by reference into the registration statement as allowed by Section 2(a)(8). *See Romine*, 296 F.3d at 708-09; *cf.* 15 U.S.C. § 77b(a)(8), quoted at App. 43a. The first misrepresentation at issue in *Romine* was an "undisclosed departure from GAAP" that misstated quarterly earnings in a registration statement; no document incorporated by reference corrected this omission. While conceding that an undisclosed departure from GAAP "almost certainly states a § 11 claim," the Eighth Circuit treated a *subsequent* corrective disclosure as disproving its materiality. *See* 296 F.3d at 703, 705-06. Purchasers in the earlier registered offering could not have known about the later corrective disclosure.

Furthermore, a recent published district court decision in a leading venue for securities cases held without qualification that Section 11 "do[es] not require disclosure of publicly available information." *Merritt v. Merrill Lynch & Co.*, 272 F.Supp.2d 243, 250-51 (S.D.N.Y. 2003). The SEC as *amicus curiae* is urging the Second Circuit to reverse this holding, which remains on appeal, as part of a trend that contradicts the text of the Securities Act and threatens to inhibit the SEC's own enforcement authority because it entirely fails to consider whether the information has sufficient public dissemination to render the omission from the actual securities filing not misleading.[1]

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[1] Brief of SEC at 1-2 & n.1, *Merritt v. Merrill Lynch & Co.*, No. 03-7978 (2d Cir. filed June 22, 2004), available at www.sec.gov/litigation/briefs/merritt.pdf; *see* Pet. 14 n.5, citing this brief. The conflict of *Merritt* with the Circuit decisions independently warrants certiorari on the important question presented because this Petition cannot await the Second Circuit's decision. ROBERT L. STERN ET AL., SUPREME COURT

(Continued on following page)

This conflict with the SEC's interpretation of the Securities Act warrants certiorari. *See Morton v. Ruiz*, 415 U.S. 199, 201-02 (1974).

The decision below, although not published in Federal Reporter, *is* published at 118 Fed.Appx. 150 (9th Cir. 2004) and Fed. Sec. L. Rep. (CCH) ¶ 93,095 (9th Cir. 2004), and contributes to the growing confusion on assessing materiality under Section 11. The Court should grant the Petition to correct this confusion in the lower courts.

A. The conflict between interpretations of materiality under Section 11 and other securities laws warrants certiorari to restore uniformity.

Respondent denies that Section 12 prospectus cases and Rule 14a-9 proxy statement cases uniformly consider only the contents of the securities filing to determine the total mix of information made available. But Respondent identifies only one case purportedly considering information outside the securities filing without restriction, *United Paperworkers Int'l Union v. International Paper Co.*, 985 F.2d 1190 (2d Cir. 1993). *See* Pet. 14 & n.4; Opp. 4-5 & n.2. That case contradicts Respondent's argument. In dictum, the *United Paperworkers* court allowed constructive knowledge only if the information is "widely reported in readily available media." *Id.* at 1199. In its holding, the court declared that "the mere presence in the media of sporadic news reports does not give shareholders sufficient notice that proxy solicitation statements *sent directly to them* by the company may be misleading." *Id.* (emphasis added). The court refused to impute constructive knowledge of eight news articles because they were too "few in number, narrow in focus, and remote in time"

PRACTICE 239 (8th ed. 2002) (citing *Gulf States Steel Co. v. United States*, 287 U.S. 32 (1932)); *see also id.* 238 ("The contrary voices of district courts obviously add to the confusion. . . .").

and "not published in the context of this proxy context," thus not "part of the total mix of information *reasonably available* to shareholders." *Id.* (emphasis added). The court founded its holding on this Court's admonition that "not every mixture with the true will neutralize the deceptive." *Id.* at 1198-99, quoting *Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1097 (1991). The contrast between the uniform decisional law under Section 12 and Rule 14a-9 and the confusion under Section 11 fully warrants certiorari to restore uniformity.

B. The auditor's duty of due diligence forms the core of the special protection that Section 11 provides to purchasers in a registered offering.

Respondent's argument fails to recognize "the special protection afforded to purchasers in a registered offering by the 1933 Act," a fundamental distinction between a Section 11 claim and a fraud-on-the-market class action. *Herman & MacLean v. Huddleston*, 459 U.S. 375, 383 (1983). This special protection arises from the "stringent standard" Section 11 imposes on auditors to demonstrate due diligence in disclosing the true financial condition of the securities issuer to purchasers. *Id.* at 381-82. That duty requires the auditor to discover and disclose any material change since the last audit. *See* Pet. 20-21. Both this Court and Congress treat due diligence as mandatory and integral to the standard of liability under Section 11. H.R. REP. NO. 85, 73d Cong., 1st Sess. 9 (1933), cited in *Herman & MacLean, supra*, 459 U.S. at 381-82 & n.12.

Like the courts below, Respondent disregards the direct relation of the materiality inquiry to the due diligence duty, cavalierly treating that duty as optional. Opp. 6 n.4. If Respondent had discharged its duty, it would have provided Petitioners actual knowledge of FPA's true financial condition; constructive knowledge would not be at issue. By charging Petitioners rather than Respondent with constructive knowledge of the undisclosed changes in

FPA's financial condition, the courts below "nullif[ied] the purposes of this legislation." H.R. REP. NO. 85, *supra*, at 9-10.

The record makes this case especially suitable for the Court to consider how the auditor's due diligence relates to materiality. Despite claiming the record contains only "undisputed evidence" (Opp. 1), Respondent prepared no statement of the case, conceding the accuracy of Petitioners' statement. *See* SUP. CT. R. 15.2, 24.2. The record demonstrates that Respondent *actually knew* – or at least would have known upon any reasonable investigation as FPA's auditor – that FPA had falsely depicted its financial condition in the registration statement, which Respondent did *nothing at all* to investigate or verify, in violation of applicable auditing standards. FPA's stock price dramatically collapsed to zero when FPA exhausted its fictitious earning stream and announced that its true net worth was negative, discrediting Respondent's claim that Petitioners could learn from market information in the "public domain" of FPA's imminent demise. It defies belief that Petitioners would trade assets worth $40 million for stock in the functionally bankrupt FPA if Petitioners had known what Respondent knew. *See* Pet. 2-6.

The decisions below place no legal significance on the auditor certification Section 11 requires for the specific benefit of purchasers in a registered offering. These decisions revive the *caveat emptor* system that the Securities Act abolished.

C. The Circuits have split on deciding materiality as a matter of law with numerical benchmarks.

Respondent does not dispute the Circuit split on numerical benchmarks, which the SEC condemns. Instead, Respondent argues that the courts below permissibly "consider[ed] quantitative factors in context" rather than applying a benchmark. Opp. 5-6. Even if this argument

were true, the decisions below would violate this Court's holding that

> the ultimate determination of materiality. . . . requires delicate assessments of the inferences a "reasonable shareholder" would draw from a given set of facts and the significance of those inferences to him, and these assessments are peculiarly ones for the trier of fact. Only if the established omissions are "so obviously important to an investor, that reasonable minds cannot differ on the question of materiality" is the ultimate issue of materiality appropriately resolved "as a matter of law" by summary judgment.

TSC, supra, 426 U.S. at 450 (footnote omitted).

II. The decision below conflicts directly with this Court's intervening decision in *Dura v. Broudo*.

Respondent's brief obfuscates the second question presented: Whether purchasers in a registered securities offering establish that the auditor's materially false audit opinions caused their losses when the company goes bankrupt because of financial conditions that the auditor knew or should have known when the registration statement became effective but failed to disclose.

Respondent misinterprets *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. ___, 125 S. Ct. 1627 (1995), which disapproved the Ninth Circuit's test for loss causation: "the misrepresentation (using language the Ninth Circuit used) 'touches upon' a later economic loss." *Id.* at 1632; *cf.* App. 22a. The "touches upon" test erred not because it made causation too easy to prove (as Respondent argues) but because it entirely severed the causation inquiry from the guidance of common-law tort principles, depriving courts of any reasoned standard for causation. *Id.* at 1631-33.

Dura concerned a situation patently absent here: securities purchasers who claimed they paid artificially inflated prices but could not plead or prove they suffered any loss thereafter. *Dura*, 125 S. Ct. at 1632-33. Contrary

to Respondent's argument, the record shows both price inflation at the time of Petitioners' investment and a nearly $40 million loss caused when "the relevant truth beg[an] to leak out." *Id.* at 1631. "The price set for an offering of securities is essentially a forecast. Price can be characterized as a present value calculation of the firm's future streams of earnings or dividends." *Glassman v. Computervision Corp.*, 90 F.3d 617, 626 (1st Cir. 1996). FPA's gross distortion of its earnings necessarily inflated its stock price.[2] Petitioners invested $40 million without knowing as Respondent did that FPA faced imminent bankruptcy; Petitioners lost virtually their entire investment "after the truth ma[de] its way into the market place." *Id.* at 1631-32. *Dura* requires nothing more.

The standardless "touches upon" test allowed the courts below to dismiss Petitioners' claims despite a nearly $40 million loss, sustained because they did not share Respondent's knowledge of FPA's imminent bankruptcy. The courts below applied a fraud-on-the-market measure of damages, defeating Section 11's purpose of permitting purchasers in a registered offering to rely on the registration statement. Congress could not have contemplated this nonstatutory measure of damages – first devised by statisticians in the 1980s – when it enacted Section 11 in 1933. *See Basic, Inc. v. Levinson*, 485 U.S. 224, 246-247 & nn.24-26 (1988); *id.* at 250 & n.1, 253-54 & nn.4-5 (White, J., dissenting). This conflicts with both the text of Section

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[2] This was evidenced by the testimony of Petitioner's accounting expert as well as the documented knowledge of FPA's chief financial officer that disclosure of its earnings management would "virtually eliminate any hope of equity raising in the future" (App. 187a). Respondent's strategic choice to hire *two* accounting experts, devoting one to auditing issues and the other to loss causation, did not leave the latter's testimony unrebutted as Respondent argues (Opp. 7-8).

Respondent's argument also ignores that Section 11 did not require Petitioners to prove causation; it required *Respondent* to prove the *complete absence* of causation. 15 U.S.C. § 77k(e), quoted at App. 45a-46a.